

BEFORE THE
U.S. DEPARTMENT OF TRANSPORTATION
WASHINGTON, DC

DEPT. OF TRANSPORTATION
DOCKETS

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In the Matter of

AMERICAN SOCIETY OF TRAVEL AGENTS, INC.,
and
JOSEPH L. GALLOWAY

Complainants

v.

UNITED AIRLINES, INC., AMERICAN AIRLINES, INC.,
DELTA AIR LINES, INC., NORTHWEST AIRLINES,
INC., CONTINENTAL AIRLINES, INC., AMERICA
WEST AIRLINES, INC., ALASKA AIRLINES, INC.,
AMERICAN TRANS AIR, HORIZON AIR INDUSTRIES,
INC., MIDWEST EXPRESS, INC., AIR CANADA, KLM
ROYAL DUTCH AIRLINES, TACA INTERNATIONAL
AIRLINES, INC., and AIR FRANCE

Respondents

Docket OST-99-6410 - //

ANSWER OF DELTA AIR LINES, INC.

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ANSWER OF DELTA AIR LINES, INC.

Delta Air Lines, Inc. ("Delta") hereby answers the October 25, 1999 complaint filed by the American Society of Travel Agents, Inc. ("ASTA"). ASTA has asked the Department to begin regulating the travel agent commissions paid by Delta -- and more specifically to reverse Delta's most recent market-based rate change, which has generally reduced Delta base commission from eight to five percent. Because the well-established legal and policy principals of deregulation preclude such rate-setting activities by the Department, ASTA has attempted to frame its request for regulation to fit within the narrow statutory authority granted to the Secretary under 49 U.S.C. § 41712 to prevent unfair and deceptive practices and unfair methods of competition.

ASTA's complaint should be rejected. There is nothing unfair or deceptive about Delta's current market-based commission rate, nor does the Delta commission rate structure constitute an unfair method of competition. It would exceed the Secretary's statutory authority -- and would contravene the expressed intent of Congress as well as established Department policy and precedent -- for the Department to engage in the type of travel agent commission rate regulation proposed by ASTA.

I. The Department, The CAB, And Congress Have Determined That Market Forces And Not Regulators Should Set Agency Commissions.

ASTA acknowledges the long settled policy to deregulate commission rates. However, it appears that ASTA only supports a deregulated marketplace when commission rates are high: "Once the airlines' ability to fix commissions by agreement was ended by the Civil Aeronautics Board, competitive forces led to the expected and inevitable rise in agency compensation to the level of 10% of the fares sold as 'base commission' for all transactions." ASTA Complaint at 9. Contrary to ASTA's assertion, here was nothing "inevitable" about the rise in commission rates, nor is there anything magic about the 10 % commission level. Just as market forces may have driven commission levels up, so too are market forces driving commission levels down.

With the advent of Internet technology, a robust economy, and extraordinarily high demand for airline seats, there is nothing surprising about the fact that sales commissions have declined in recent years. This does not reflect a failure of the marketplace, but rather is evidence that the marketplace is working efficiently. Nor does the decline in commission rates evidence of any intent (or ability) on the part of carriers to drive travel agencies out of business.

ASTA has correctly identified the Internet as a factor in declining commissions. However, this is not, as ASTA suggests because “the Airlines believed they could control directly the information provided to the public without meddlesome interference by travel agents . . .” Complaint at 10. Rather, the Internet is important because it has created a widely accepted and economically efficient alternative distribution outlet.

A highly relevant parallel example of declining commission rates can be found in the market for brokerage services. Before Internet services were widely available to investors, it was not uncommon for traditional brokerage firms to charge stock trade execution orders of hundreds of dollars per transaction. Now, investors can execute their trades online for less than ten dollars per transaction. The Internet has resulted in substantial commission savings to investors – not only for those who trade online -- but also for those who use more traditional methods, due to an uncontrollable spillover effect created by the

dramatically lower rates and efficiency of online trading. The Department should no more regulate commission rates paid to travel agents than the SEC should regulate higher rates for brokerage firms.

Not only does common sense and sound public policy mandate a hands-off approach to travel agent commissions, but the Department has not been given the statutory authority to engage in the regulation of airline distribution channels and agency commission rates. Through its passage of the Airline Deregulation Act, Congress mandated that the Department allow competitive market forces, not governmental regulation, to determine commission rates. Thus, the CAB long ago concluded that the “Airline Deregulation Act of 1978 significantly altered the policy directives that guide the Board’s consideration . . . and the public interest demands even greater reliance on the free interplay of actual and potential competitive forces. ” Order 79-9-65 at 3.

The CAB and the Department have affirmed the appropriateness of a market based, non-regulatory commission rate system on numerous occasions:

- 🐾 🐾 🐾 [w]e think that the distribution system that evolves should be determined by the marketplace. Order 82-12-85 at 6.
- Application of competitive principles that apply to unregulated industries is not incompatible with the basic structure of a distribution system in which air carriers use common agents. Id. at 5.

- ☞ ☞ ☞ individual air carriers have the right to require their agents to adhere to the prices they set if they conclude that it is in their economic interest. Id. at 91.
- ☞ ☞ ☞ we conclude that the only assurance that commission payments are reasonable can come from the operation of the unfettered marketplace. Order 83-3-127, 83 CAB Lexis 322 at 43.
- ☞ ☞ ☞ experimentation and nonuniformity of commission rates would seem to be an inevitable and desirable result of the deregulation of the air transportation industry. ” Order 80- 12-11 at 6.
- Delta’s behavior appears consistent with the freedom air carriers have to market their air transportation services at any price, with any incentives that they wish – subject, of course, to legal constraints confronting all businesses. Order 90-1-3 1 at 3.

Ever since the CAB deregulated commissions, various travel agents and organizations such as ASTA have complained that airlines would use their power to set commissions to drive travel agents out of business. That has not happened in the twenty years following deregulation, because airlines benefit from the sales activities performed by travel agents, and will continue to do so as long as travel agents are willing to perform those services at market rates that are competitive with other distribution channels.

ASTA claims that it needs protection and government regulation to ensure the financial viability of travel agents, and requests the Department to exercise its power under § 4 17 12 to curb the allegedly “unfair” competitive practices of the airlines in lowering commissions. However, ASTA has failed to demonstrate any harm to competition or the public interest. It is well established that the § 4 17 12 remedies available to the Department are intended to protect

competition, not individual competitors. As such, it would exceed the Secretary's statutory authority and contravene the intent of Congress if the Department were to use § 41712 as a basis to reregulate travel agent commissions.

II. ASTA's Implausible Hypothesis:

Recognizing that deregulation and § 41712 do not support broad regulation of commission rates, ASTA's complaint fabricates a highly implausible two-part conspiracy theory in an effort to shoehorn this call for commission rate regulation into the very limited "unfair competitive practice" reach of § 41712:

- First, ASTA claims that the airlines have devised a scheme to drive travel agents out of the distribution chain by effecting a "revenue squeeze" and by intentionally exporting costs onto travel agents.
- Second, once travel agents are driven from the marketplace, helpless consumers would be blind and unable to find low fares, thereby enabling carriers to unfairly compete by exploiting uninformed consumers' weaknesses.

Travel agents play an important role in Delta's ticket distribution network, and Delta is disappointed that ASTA would use such false and misleading accusations to try and persuade the Department to regulate this segment of the industry. Because travel agents provide a valued service for their airline principals, carriers would not benefit if travel agent services were not available to airline customers wanting to use them. However, in an increasingly

competitive marketplace, travel agents must continue to find ways to improve their economy and efficiency to keep pace with improvements in distribution technology through other mediums, and should not rely on government rate regulation to ensure their financial viability.

Many types of businesses, including, for example, brokerage firms, retailers, and automobile dealers, have had to find ways to remain competitive on smaller margins as the Internet has created new efficiencies and exerted downward pressure on commissions. The travel agency business is no different, and there is no reason for the Department to set commission rates when similar guarantees are not provided to retailers in any other sector of the economy.

The current commission schedule represents the rate that the competitive marketplace has put on the value of the selling effort performed by travel agents for the airlines. Nothing more, nothing less. There is no basis for the Department to substitute its judgment for that of the marketplace, or to infer that the commission rates are based on anything other than rational independent decisions by the airlines.

The second part of ASTA's conspiracy theory is even more far-fetched – namely that the airlines hope to “unfairly compete” by “exploitation of

consumers' inability to obtain the lowest price when dealing directly with [the airlines] ” Complaint at 20.

Airlines cannot possibly hope to restrain consumers' access to low fares in the “Information Age. ” There are many Internet sites available for comparing airline fares and the list is growing daily. For example, the Washington Post just this week reported the development of a powerful new search engine designed to ferret out low fares, compare alternative airports, evaluate departure time windows, and help consumers evaluate cost savings in relation to frequent flyer program benefits. See Attachment 1.

The airline business is a fiercely competitive industry, and pricing is one of the most important factors in a consumer's choice of carrier. Consumers have, in addition to travel agents, a number of methods for obtaining comparative fare information, including the Internet, newspaper and print advertisements, travel related publications, and simple comparison shopping. As a result, airlines have a powerful incentive to offer the lowest price available to consumers who qualify for a particular fare, or risk losing that business to a competitor.

ASTA's hypothesis that airlines could increase profits by “hiding the ball” from consumers and forcing them to pay more for air transportation by not

revealing the lowest fares is belied by the practical impossibility of restricting the flow of comparative fare information to consumers and the inherent competitiveness of the airline industry.

Rather than looking to the government to guarantee profits and future viability through regulation, travel agents should seek ways to improve their own efficiencies and enhance the value of services which they offer to consumers. For example, in light of declining airline commissions, many travel agents have focused on increasing the segments of their business dealing with land packages, hotel bookings and cruises.

Moreover, if, as ASTA contends, consumers are able to obtain airfare and booking information more efficiently and with lower transaction costs when dealing with travel agents rather than the airlines, then consumers should be willing to pay for the added benefit of those services. Indeed, many travel agencies have adopted a policy of charging modest services fees. This is an efficient market result, with consumers that are actually using travel agency services paying for them directly. There is no need for the government to regulate commission rates and force all airline consumers, whether or not they use a travel agent, to subsidize regulated above-market commission rates.

III. ASTA's Anecdotal Accounts of Cost Exportation are Without Merit.

While the crux of ASTA's complaint is that carriers are attempting to drive travel agents out of business through a "revenue squeeze", ASTA also complains that the airlines are attempting injure travel agents by imposing artificial costs on them. This is untrue. ASTA's allegations are, at best, anecdotal. A few examples are illustrative:

ASTA complains that the airlines and ARC have imposed "unnecessary ticket security requirements" in forcing travel agents to obtain a locking safe to protect ticketing stock. However, the modest security requirement for agencies to have a locking safe on premises to protect these valuable documents is a reasonable and prudent security precaution designed for travel agents' financial protection and has absolutely nothing to do with any intentional cost exportation by airlines on to travel agents.

ASTA also complains that airlines are refusing to pay commissions on passive segments and that airlines have taken steps to charge back passive segment fees by CRSs to travel agents. However, passive segment bookings produce no benefit to the airlines, and the current travel agency/subscriber contracts can result in a limited number of unscrupulous agents booking passive segments solely to earn "productivity" credit kickbacks from CRS vendors.

This is a serious problem and has been fully addressed by Delta and other airlines in comments in the CRS rulemaking docket (OST-97-2881). Rather than sympathizing with ASTA, the Department should act to put an end to this harmful and unproductive practice altogether. In the meantime, airline efforts to police and discourage this practice should in no way be construed as part of any general malevolence towards travel agents.

The other anecdotal accounts of cost exportation issues raised by ASTA are equally without merit. It is worth noting, however, that ASTA has not requested the Department to intervene with any of these so-called “cost squeeze” tactics; the only remedy ASTA is requesting is a regulatory reversal of the current market-based commission rate, which would directly increase compensation to ASTA’s members.

IV. Specific Allegations

ASTA’s complaint, is, for the most part general and argumentative in nature, and does not lend itself to a particularized list of admissions and denials. Delta generally denies the allegations of the complaint. However, to the extent necessary, Delta states more specifically as follows:

1. Delta denies that it competes with its travel agents or that it has market power over travel agents.

2. Delta denies that it has “embarked on a campaign to eliminate or at least severely impair the public’s access to travel agents.” Complaint at 10.
3. Delta denies that it has restricted low fare information to consumers or that consumers are unable to obtain the lowest Delta fares when dealing directly with Delta. Complaint at 19-20.
4. Delta admits that it has reduced its base commission rate from eight to five percent, but only insofar as the commission rate change reflects competitive marketplace conditions.
5. Delta denies that it has engaged in any intentional exportation of unnecessary costs to impair travel agent efficiency as alleged in the “cost squeeze” section of the complaint.

V. Affirmative Defenses

1. The complaint fails to state a cause of action upon which relief can be granted.
2. The relief sought by complainant is precluded by the Airline Deregulation Act.
3. The relief sought is barred by waiver and estoppel, as embodied in the travel agency agreements.
4. The complainants lack standing to bring this action.

VI. Conclusion

ASTA's complaint should be dismissed. While an artificially mandated commission rate increase would certainly be in ASTA's members' interest, it is not in the public interest and is not necessary to prevent any unfair or deceptive practice or unfair method of competition. Accordingly, the Department should reject ASTA's call for regulation and continue to follow DOT's well-settled policy and precedent by continuing to leave commission rates to market forces.

Respectfully submitted,



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The Second.coming

By Craig Stoltz
Washington Post Staff Writer
Sunday, December 5, 1999

A technologically advanced Web site for finding low domestic air fares--one that is easier, more powerful and better tuned to user needs than the fare tools used by **Expedia**, **Travelocity**, **Preview Travel** and other online travel leaders--is now available for use in a prerelease form. It's so much better than the others that it's worth adopting now for U.S. and Canada fare searches, even in this imperfect, limited version.

The unnamed air-fare search tool (located at www.itaoftware.com) was developed by former students in the Massachusetts Institute of Technology's renowned Artificial Intelligence Lab--the place where many of the exotic digital technologies that show up on the pages of **Wired** are born. I previewed the site, developed by the Cambridge, Mass.-based **ITA Software**, at its first public showing in November at **PhoCusWright**, an annual online travel meeting. Since then, the staff of The Washington Post Travel section and I have been testing the site, both to shop for our own travel and to perform research for stories, comparing results with those from established fare-search tools. When the site works (like any beta site, it's balked a bit), it consistently returns more lower-priced options, and better choices, than the leaders. On these pages we've often taken online travel agencies to task for claiming to deliver "lowest prices" and "ease of use" when in fact they deliver neither. **ITA's** software appears to be the first online fare tool capable of delivering.

A few caveats are in order. The site has a serious limitation--right now it works only when researching domestic and Canadian flights. (According to **ITA Software** President and CEO **Jeremy Wertheimer**, international flights will be added, in stages beginning with European flights, throughout next year.) And the site does not yet permit online booking of the air fares--you can print or copy down the information and take it to a travel agent, to the airline itself, to the airline's Web site or to another online travel agency to do the deed. And unlike online agencies, the site is now bare--no hot deals, no destination or lodging information, no package deals or cruises.

So what's the big deal? The **ITA** site's flight-search request--the form you fill out to tell the software what trip you'd like priced--corresponds masterfully with most shoppers' needs and desires. And once the request is tendered, the search engine returns the most thorough, flexible and usefully parsed array of fare and flight choices available on the Web. If the typical fare-search tool shines a narrow flashlight beam into a dark room to illuminate a specific group of fares, **ITA** turns on all the lights in the air-fare warehouse and lets you see pretty much all the lower-priced options in a single view.

For instance, ask the software to quote prices on a flight from Washington to Los Angeles. Before you start the search, it will let you open the query to any airports within a mileage range you choose (25, 50, 100 miles or more) or to any airports you specify (say, Dulles or National but not BWI, to LAX or Ontario but not John Wayne; be sure to separate airport codes with a semicolon, no space). You can also ask the tool to scan for flights within a time window ranging from two hours to two days, with different specs possible for departure and return.

All this is good but the best stuff is yet to come. When the site returns your answer, you see a screen highlighting the lowest prices that each carrier charges for that route during the time frame you've specified (thus answering the until-now-hard-to-answer "How much will it cost me to fly my frequent-flier carrier as opposed to the cheapest flight?"). It also lets you view price differences between flying direct and connecting once or twice. Click on "by airport," and the software slices the results so that you can see how much you save (or not) by using alternate airports. Is it worth it to fly from BWI with one connection instead of from National direct? What will it cost to fly to Seattle for vacation instead of San Francisco? Finally, you can make such calls with all the information you need--costs, times and routes. You can also parse flights by time, if schedule is important in your calculations.

Unlike most of the competition, ITA's engine lists flight options only after it has verified the availability of the number of seats you've requested. (The exception is flights on Southwest, whose prices ITA quotes even if they are not available. Southwest has contracts that limit its availability information to a tight list of partners.)

It keeps getting better. When you click on any fare for more information, you get airport-to-airport elapsed time (allowing you to add this to your value calculation), plus most caveats in plain English. If a connection you've chosen is very tight, the software inserts a red warning message in the margin. If a low fare routes you out of one airport and back via another, it red-flags that, too. It highlights some (but not all) of the conditions (such as nonrefundability) attached to highly restricted fares. It gives you all the booking information you need to consummate the transaction with the airline, a travel agent or another Web site. It even includes that elusive "fare code" information--so your agent won't be able to say he can't find the fare.

As anybody who has spent much time growing old and angry with the leading online travel sites knows, what I'm describing here is indeed worthy of the term "breakthrough," if not quite "godsend." It has the potential to be what the denizens of electroland call a "disruptive technology"--one so different and obviously superior that it threatens to realign an established marketplace in one swoop.

It is true, as the current online travel leaders will certainly insist, that not all customers come to the Web merely to find the cheapest air fares most easily. Some of them shop for specific times or carriers rather than low fares, some want one-stop shopping for air, lodging and cars, some want package deals and cruises, some want destination and planning information and some I suppose even want that "sense of community" and

"interactivity" that e-commerce marketing people (and only e-commerce marketing people) croak about. But my guess is that the number of people who want the cheapest air fares most easily dwarfs the number of people looking for the other stuff--and that once this fare-search tool gets put in the marketplace by someone who adds booking, lodging and other features, it will quickly become the preferred site of savvy users. It will certainly obligate the others, principally **Expedia** and **Travelocity**, to continue their baby-step improvements to their older, more airline-centric fare-search technologies.

For now, the **ITA** fare searcher is a piece of technology in search of a commercial home--a company that can build an online travel business around this powerful, patented and potentially market-shaking piece of programming. I confess that I have fears that it will fall into the wrong hands, like the mythical 200 mpg carburetor allegedly invented by some engineer in the Midwest but purchased and then buried forever by terrified oil company executives. (Amadeus, a European company that operates one of the major clunky old central reservation systems long used by travel agents, is a 20 percent owner in **ITA Software**, but that arrangement doesn't preclude **ITA** doing deals with most other commercial partners.)

Wertheimer has been working on this project since 1992, when he was a grad student at MIT, and clearly takes satisfaction from having developed the software.

"It was fun," he says. "It was a hard problem, and we've solved it." He's been negotiating with various companies, including airlines, travel retailers and other groups, about forming a business relationship. He plans to add additional features and different kind of searches as the product comes to market. "Now the question is, what are we going to do with it?"

To Try **ITA's** Fare Tool

To use the "beta" (i.e., **pre-release**) form of **ITA's** flight-booking software, go to **www.itasoftware.com**. First click on the Our Technology button on the left, which provides a product overview. Then click on Try Our Beta Site; you'll need to register a logon name and password to use it. The site is simple to use (assuming you know the codes of the airports you want to check out; if not, go to <http://www.flyaow.com/citycode.htm> and bookmark the page). Use the Help function if you need to; the site, like many beta products, was balky last week, refusing to recognize some airport codes.

Repeating the request seemed to fix the problem. Feel free to send feedback to **ITA** via the e-mail link (and copy it, if you like, to travel@washingtonpost.com). Unless you and your machine are really Java savvy, don't click on the "Use Java Client" box--it's for serious data-heads only.

CERTIFICATE OF SERVICE

I hereby certify that I have this 10th day of December, 1999, served the foregoing Answer of Delta Air Lines, Inc., on those persons below via first class mail, postage prepaid.

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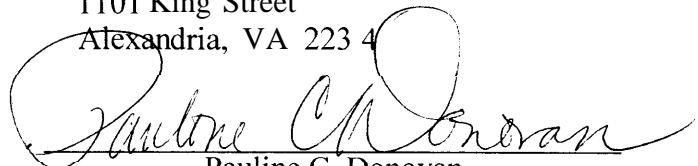
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